

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

CENTRAL ILLINOIS LIGHT COMPANY)	
D/B/A Ameren/CILCO)	
)	No. 05-0160
Proposal to implement a competitive procurement)	
Process by establishing Rider BGS, Rider BGS-L,)	
Rider RTP, Rider RTP-L, Rider D, and Rider MV)	
)	
CENTRAL ILLIONOIS PUBLIC SERVICE COMPANY)	
d/b/a AmerenCIPS)	
)	No. 05-0161
Proposal to implement a competitive procurement)	
Process by establishing Rider BGS, Rider BGS-L,)	
Rider RTP, Rider RTP-L, Rider D, and Rider MV)	
)	
ILLINOIS POWER COMPANY)	
d/b/a AmerenIP)	
)	No. 05-0162
Proposal to implement a competitive procurement)	
Process by establishing Rider BGS, Rider BGS-L,)	
Rider RTP, Rider RTP-L, Rider D, and Rider MV)	

Direct Testimony of

Harvey Salgo

Submitted on behalf of the
People of the State of Illinois

June 15, 2005

AG Ex. 2.0

I. INTRODUCTION

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Harvey Salgo. I am a principal consultant with La Capra Associates,
3 which is located at 20 Winthrop Square, Boston, Massachusetts.

4 Q. FOR WHOM ARE YOU TESTIFYING IN THIS PROCEEDING?

5 A. I am testifying on behalf of the People of the State of Illinois.

6 Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF YOUR QUALIFICATIONS.

7 A. I am an economist and attorney and have worked in the electricity business for
8 almost thirty years. I have wide ranging experience both domestically and
9 internationally; and much of that work has involved sector restructuring issues
10 and power procurement. Internationally, I have worked extensively in a number
11 of countries on a variety of complex assignments, and domestically, my clients
12 have also been varied. I have worked with state governmental agencies, such as
13 state attorneys general, consumer advocates and large industrial/commercial end
14 users, and have testified as an expert witness on several occasions. My resume is
15 attached as AG Exhibit 2.1.

16 Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF THIS PROCEEDING AND
17 THE COMPANY'S PROPOSAL.

18 A. This case is a major procurement and ratemaking proceeding to review the
19 proposal submitted by Ameren CILCO, Ameren CIPS, and AmerenIP
20 ("Ameren") to meet its load serving obligations for the period beginning January
21 1, 2007. The Commission is being asked to review and approve Ameren's

1 proposed supply portfolio design and to review and approve Ameren's proposed
2 procurement method – an annual auction – which would be used to procure the
3 capacity and energy in its proposed portfolio.

4 Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR TESTIMONY AND
5 CONCLUSIONS.

6 A. My testimony focuses primarily on the portfolio design and the auction-based
7 procurement process proposed by Ameren to implement that portfolio design.

8 The conclusions that I have reached are as follows:

9 1) Ameren has not compared its proposed portfolio design (overlapping 3-
10 year fixed price, full requirement contracts) with other portfolio designs
11 that are reasonable alternatives for procuring electricity for bundled
12 customers. There is no analysis indicating that Ameren's proposal will
13 produce lower rates and/or lower levels of risk for residential and small
14 commercial customers than other portfolio options.

15 2) There are many alternative ways to design and procure a portfolio.
16 Ameren's proposal will shift the risks to suppliers¹, and consumers will
17 ultimately pay the price for the suppliers to absorb those risks. This
18 approach is not likely to minimize costs or risks to consumers. Other
19 portfolio options such as alternative agency arrangements, different
20 contract terms or a different mix of products should be evaluated to

¹ Blessing Ex. 3.0 p. 5 (line 10-105), "The full requirements...product places certain risk, including price and volume risk, on the BGS supplier...This allows Ameren Companies to concentrate on what they do best."

1 identify alternatives that could reduce costs and risks to consumers.

2 Alternative portfolio designs should be given full consideration because of

3 the magnitude of the decisions at issue in this proceeding.

4 3) Ameren's implementation plan calls for all energy and capacity to be
5 obtained in a single annual descending clock auction. This is only one of
6 many ways to obtain energy and capacity. Ameren's failure to present an
7 analysis of other options – such as bilateral contracts – means that
8 opportunities for consumer savings may be overlooked.

9 4) Ameren proposes to procure an extraordinarily large volume of electricity
10 in the first auction and, more generally, would rely on large and discrete
11 auctions conducted once per year to implement its plan over time.
12 Assuming, for argument's sake, that Ameren does procure the proposed
13 full requirements contracts for bundled service customers, it has not
14 demonstrated that a one-time annual auction is the best way to do so.
15 There are significant risks associated with relying on large, one-time
16 auctions, particularly in 2006, when Ameren proposes to procure 100% of
17 its requirements for 2007 and additional amounts for the following years
18 in a single auction.

19 5) The proposal limits the extent of review that the Commission can exercise
20 before and after the auction. As a practical matter, the auction *process*
21 will be reviewed; but there is not likely to be time for a substantive review
22 of the resulting prices within the review period (3 business days following
23 the auction) that has been proposed.

1 **II. DESCRIPTION OF ISSUES**

2 Q. PLEASE DESCRIBE BRIEFLY THE COMPANY’S PROPOSAL.

3 A. To obtain electricity for its bundled customers, Ameren proposes to procure a set
4 portfolio of full requirements contracts² which would be awarded through a single
5 descending clock, vertical tranche auction. Ameren proposes to hold subsequent,
6 annual auctions to replace expiring contracts which would be equivalent of one-
7 third of load.

8 Non-residential customers over 1 MW (Large Commercial and Industrial
9 customers, LC&I) that ‘opt-in’ would be supplied through a 1-year fixed price,
10 full requirements contract (BGS-LFP)³; and the residential and below 1 MW non-
11 residential customers (Residential and Small Business customers R&SB) would
12 be supplied through fixed price, full requirements contracts of overlapping 3-year
13 durations (BGS-FP)⁴. After the initial procurement of 17-, 29-, and 41-month
14 contracts, subsequent auctions would be for 3-year contracts equal to one-third of
15 load each year, resulting in overlapping 3-year contracts. The remaining greater

² I use the term full requirements product, as does Mr. Blessing (Ameren Ex. 3.0 at page 5), to mean “...wholesale electric power supply that includes both capacity and energy. In addition, the suppliers will be financially responsible for the ancillary services, which will be procured by the Ameren Companies.”

³ BGS-LFP refers to Basic Generation Service—Large Customer Fixed Pricing

⁴ BGS-FP refers to Basic Generation Service—Fixed Pricing: The first auction will be for contracts of somewhat different durations, as they will run from January forward, rather than from June 1 as proposed for subsequent auctions.

1 than 1 MW customers who do not opt-in to a fixed price option would be served
2 through a real-time pricing product (BGS-LRTP)⁵..

3 Q. PLEASE PUT THE MAGNITUDE OF THE LOAD THAT WILL BE
4 PROCURED INTO CONTEXT?

5 A. These contracts represent up to 8000 MW peak load for the three utilities
6 combined. If the purchase were for a single year for up to 8000 MW of load, at a
7 load factor of 60%,⁶ Ameren would need to acquire roughly 42,000 GWH. And,
8 since Ameren's proposed portfolio of contracts in its initial auction is for 17-, 29-,
9 and 41-months, the actual amount of electricity to be purchased is much greater.
10 Although not as large as ComEd's proposed procurement, it is still a very large
11 procurement. Auctions in subsequent years would be for smaller amounts (33%
12 of load), although they would still be substantial.

13 Q. WHAT PROVISIONS CURRENTLY EXIST FOR FUTURE SUPPLIES FOR
14 BUNDLED-SERVICE CONSUMERS?

15 A. Ameren has contractual commitments under a full requirements contract to supply
16 bundled-service customers through the end of 2006. According to Ameren
17 witness Warner Baxter, after 2006 "each of the Ameren Companies must
18 purchase its supply in order to provide any generation service." Ameren Ex. 1.0
19 at 4-5.

⁵ BGS-LRTP refers to Basic Generation Service-Large Service Real-time Pricing.

⁶ Illustrative load factor estimated from peak load and total energy sold in 2004 for all Ameren Companies' service territories.

1 At this juncture, bundled-service customers have very little, if any,
2 opportunity to directly obtain alternative supplies on their own behalf from the
3 retail market for service in 2007 and beyond. At the end of 2006, arrangements
4 must be made to secure energy and capacity for the bundled-service customers
5 that do not have competitive retail market options.

6 Q. HAS THE COMPANY SHOWN THAT THE AUCTION PROPOSAL WILL
7 PRODUCE LOWER RATES FOR BUNDLED CUSTOMERS THAN OTHER
8 PROCUREMENT OPTIONS?

9 A. No. There is no analysis presented as to whether Ameren's auction proposal will
10 result in lower rates for consumers than other procurement methods; and there is
11 no indication that the proposed mix of products will result in lower rates than
12 other products that could be procured through an auction or through bilateral or
13 other contracts. Though Ameren indicated that it considered alternatives to the
14 auction proposal (Ameren Response to AG 2.28), it has not provided any analysis
15 as to whether obtaining full requirements contracts through an annual auction of
16 the type Ameren has proposed will produce lower rates than other methods that
17 could be employed.

18 In response to AG data request 2.4, Ameren stated that "in order to
19 minimize the supply cost to serve its customers it must procure power from the
20 market in a least cost manner. This entails utilizing a procurement mechanism
21 that will attract as many suppliers as possible and result in a competitive outcome.
22 The Ameren Companies auction proposal was designed to result in a competitive
23 outcome." (Ameren Response to AG 2.4) This statement assumes that the

1 “competitive outcome” produced by the auction is the “least cost” at which power
2 could be procured. The competitive outcome may result in the lowest price for all
3 the supply procured in that particular auction, but that is not necessarily the lowest
4 price at which electricity could be obtained with reasonably acceptable risk.
5 Ameren’s statement carefully avoids any representation that the procurement
6 method being proposed or the product being procured will minimize costs and/or
7 risks to customers.

8 Q. HAS THE COMPANY SHOWN THAT THE COMPANY’S PROPOSAL WILL
9 MANAGE RISK EFFECTIVELY FOR BUNDLED CUSTOMERS?

10 A. No. The Company’s proposal clearly transfers its risk to suppliers and customers.
11 However, the Company has not directly addressed the risks to bundled customers,
12 or whether its proposal is likely to result in reasonable levels of risk exposure for
13 bundled customers. Ameren’s witness, Mr. James Blessing believes that “to the
14 extent suppliers have less ability to hedge for longer term products than for
15 shorter term products, this could increase the risk of supplying longer term service
16 at fixed prices.” (Ameren Response to AG 2.2) However, the Company’s
17 presentation does not indicate that it evaluated the magnitude of risk premiums on
18 suppliers’ bids or on the prices that customers would be asked to pay. One
19 cannot be indifferent to the magnitude of these risk premiums, given that full
20 requirements contracts shift all volume risk to suppliers and that there are other
21 portfolio options that may entail less risk.

22 Ameren offers testimony that the two objectives of the supply portfolio
23 design in its auction proposal are “(1) to facilitate stable but market based

1 rates...[and] (2) to minimize those market based rates through minimization of
2 supplier risk and appropriate allocation of risk by customer group.” (Ameren
3 Response to AG 2.1.) The Company’s testimony does not address the tradeoff
4 between price and risk for the proposed and other possible portfolios or non-
5 auction procurement strategies. In addition, the Company has not addressed the
6 substantial risk associated with the initial auction, which is intended to secure all
7 supplies for 2007 and more in a single event.

8 Q. WHAT IS THE BASIS FOR YOUR UNDERSTANDING THAT THE
9 COMPANY HAS NOT EXPLICITLY CONSIDERED THE EXTENT TO
10 WHICH RATES MAY BE INCREASED BY RISK PREMIUMS THAT
11 SUPPLIERS WILL INCLUDE TO COVER VARIOUS RISKS?

12 A. The Company’s testimony does not estimate the potential costs that consumers
13 could be asked to pay to cover the risks that would be shifted to suppliers through
14 the proposed auction. Further, in response to a data request regarding the risk
15 premium that might be required to cover “...variability in sales levels” or “fuel
16 price variability” for 1-year supply contracts, the Company states that it “does not
17 possess and is not aware of any such research.” (Ameren Response to AG 2.9 and
18 AG 2.10.)

19 Q. IS THERE ADDITIONAL INFORMATION THAT THE COMPANY SHOULD
20 PRESENT IN THIS PROCEEDING?

21 A. With respect to obtaining supply for bundled service customers, the Company
22 should address the following questions:

- What are the tradeoffs between price minimization, price stability and other objectives for the provision of this supply?
- Are the products that will be acquired consistent with these objectives?
- Are there alternative procurement methods that would result in lower rates and less risk for bundled customers than under the auction proposal?
- If an auction is used to procure electricity, is the once per year auction the best way to acquire the products for the initial auction and for subsequent auctions?

III. PORTFOLIO DESIGN ISSUES

Q. PLEASE DESCRIBE WHAT YOU MEAN BY PORTFOLIO DESIGN.

A In its simplest terms, I use the term ‘portfolio design’ to refer to the entire mix of power supply arrangements assembled to serve load over time. A portfolio can encompass many different kinds of supply to meet load, including combinations of standard market product purchases (e.g., baseload, peak, super-peak, full-requirements, or load-following products) and unit contingent contracts (contracts for output from specific facilities, either conventional or renewable generators) with different contract durations and pricing options (fixed price, tolling, index price), as well as plans to secure some portion of the requirement from the spot

1 market. In the context of this testimony, the discussion will focus on the
2 Company's proposed "portfolio" of fixed priced, equivalently-sized, vertical
3 tranches of full-requirements contracts and alternatives to that specific portfolio
4 approach.

5 Q. WHAT ISSUES SHOULD THE COMPANY, AS A PURCHASER OF RETAIL
6 LOAD, CONSIDER IN ESTABLISHING ITS PORTFOLIO TO GET THE
7 LOWEST PRICES?

8 A. The Company has patterned its proposal on the New Jersey Basic
9 Generation Service (BGS) model and has rejected procurement models that
10 involve active portfolio management, apparently to limit its own risk exposure.
11 Given the scale of the proposed procurement, the Company should fully consider
12 other approaches, including more active portfolio management, utilization of the
13 many other standard products available in the market, such as various standard
14 blocks of power (such as base load 7x24 products) or unit contingent agreements
15 and the possibility of negotiating prices and other contract terms with suppliers.
16 The Company should directly compare its proposed portfolio design with these
17 other options, in terms of projected rate impacts and risk exposure for bundled
18 customers.

19 As a large buyer for retail load in central and southern Illinois, Ameren
20 currently has substantial buying power and a strong bargaining position. Its large
21 scale and scope could enable it to purchase a range of standard products available
22 to larger buyers, to reduce its transaction costs, and to use considerable

1 transaction expertise to manage its portfolio and risk. These and other factors
2 should be addressed in assessing future portfolio approaches.

3 Q. PLEASE BRIEFLY DESCRIBE YOUR CONCERNS REGARDING THE
4 COMPANY'S PORTFOLIO DESIGN CHOICE.

5 A. As I noted earlier, the Company proposes to adopt a similar version of
6 overlapping 3-year fixed price full requirements contracts as the New Jersey BGS
7 model. My concerns with the Company's portfolio design fall into two broad
8 categories: (1) the concept of price stability versus price fixity and its implication
9 on portfolio design and (2) the fact that the Company is proposing to use only one
10 type of contract to serve its load.

11 Q. CAN YOU DESCRIBE THE CONCEPTS OF PRICE STABILITY AND PRICE
12 FIXITY?

13 A. The Company evidently has interpreted the concept of price stability to be the
14 equivalent of price fixity. The two are not the same. However one defines the
15 terms, prices can be relatively stable without being fixed.

16 In this vein, it is important to distinguish between 'cash flow' effects and
17 expected total cost over the duration of fixed price contracts. That is, while it
18 may be easier to budget for a fixed price product because one always knows the
19 price, some monthly variation in prices may be preferred if the total annual cost
20 may be lower. These are substantive matters that are ordinarily assessed and
21 analyzed in the development of a portfolio that may consist of a mixture of supply
22 options.

1 Consider an analogy. Suppose that one is offered the choice between: (1)
2 a medical insurance product that covers all costs, including the total cost of any
3 prescribed medicines and other treatment; and (2) medical insurance that covers
4 the same costs, albeit up to a maximum. Clearly, the second presents some risks,
5 akin to a partial open position in the electricity business. But without more
6 information – related to the probability and size of the financial exposure, relative
7 prices of the insurance products, ability to absorb the risk, etc. – it is not possible
8 to decide which to select, unless one assumes that regardless of the price of full
9 coverage, people would always choose to avoid risk. It is this assumption that
10 the Company seems to have made in designing its proposed portfolio.

11 While it is true, as the Company maintains, that suppliers will absorb the
12 various risks⁷ of providing fixed price, full requirements service -- this will
13 obviously come at a price. And, all else equal, the greater the risks to be
14 absorbed by the supplier, the higher the price for doing so. The key question
15 remains: Would bundled service customers be better off with the Company's
16 proposed fixed-price portfolio; or would some modest openness to variability be
17 acceptable?

18 I should note that my reference above to “modest openness to volatility”
19 may include an open position in the portfolio. But I should also note that I am not
20 suggesting that an entirely open position for bundled customers should be

⁷ The risks that suppliers of full requirements, fixed price contracts will need to evaluate and price – since they will absorb those risks – include load growth net of migration, gas prices (as the contracts require load following capability), other fuel prices, congestion costs, capacity costs, and so on.

1 entertained. Indeed, my view is that an entirely open position is too risky for
2 these customers, who would have little or no success in acquiring an appropriate
3 hedge on their own. The key questions here are: What is an acceptable tradeoff
4 between price and risk? And do the products that have been selected by the
5 Company best reflect that tradeoff?

6 Q. WHAT ARE YOUR CONCERNS REGARDING THE EXCLUSIVE USE OF
7 THREE YEAR, FIXED PRICE, FULL REQUIREMENTS CONTRACTS?

8 A. The Company has not explained why only 3-year fixed price full requirements
9 contracts are in the proposed portfolio or characterized the extent of the risks
10 associated with having all contracts with the same term. Ameren admits that
11 suppliers' bids on the 3-year contracts will reflect risk premiums related to the
12 supplier's ability to hedge such risks in the market that may be greater than
13 shorter term contracts. BGS-FP customers would ultimately pay whatever
14 premium is included to cover these risks.

15 I should be clear that, in principle, I am not opposed to longer term
16 contracts. In this situation, however, the Company has not presented a rationale
17 for 'testing' the market for three year, full requirements, fixed price contracts.
18 These are high priced, premium products that shift all management of volume and
19 fuel price risk to each supplier, while relieving the purchaser (*i.e.*, the utility) from
20 all management responsibility. Does the Company believe that the bundled-
21 service customers would be better off with these 3-year, full requirements
22 contracts than if it were to shorten the contract durations more generally or use
23 alternative contract terms? Given the size of the proposed procurement, the

1 answers to these questions have enormous financial implications and need to be
2 addressed in this proceeding.

3 Q. WHAT ARE YOU RECOMMENDING REGARDING THE DESIGN OF THE
4 COMPANY'S PORTFOLIO?

5 A. My recommendation is that the Company evaluate other product options and
6 portfolios. For instance, how did the Company derive its portfolio options? And
7 how did it weigh the risks and benefits? Presumably, the Company could have
8 opted for, say, a portfolio constructed entirely of one year contracts (for calendar
9 2007) with the same or different pricing and supply obligations. Other portfolio
10 options could include various standard blocks of power (such as base load 7x24
11 products), unit contingent agreements, and might include a modest open position.
12 A thorough comparison of other portfolio design options is needed to assess the
13 relative risks and benefits for bundled-service customers, who will ultimately pay
14 the bill.

15 The analysis should include an assessment of resource mix, pricing
16 options and contract duration and recognize that price stability and price fixity (or
17 certainty) are not synonymous with one another. This analysis should expressly
18 consider the goals of price minimization and risk management. By equating
19 price stability and price fixity (or certainty), the Company's portfolio has
20 devolved into a collection of fixed price, full requirements contracts. However,
21 the Company should at least consider diversifying its portfolio to examine other
22 product options, to the extent they would result in reasonable rates and reasonable
23 bill variability.

1 Q. WHY IS IT IMPORTANT TO ADDRESS THESE MATTERS RELATED TO
2 PORTFOLIO CHOICE IN THIS PROCEEDING?

3 A. It is essential to do so because, as I understand it, the Company proposes to
4 continue with the same contractual structure as long as it retains a service
5 obligation. And, while the proposal contemplates annual Commission review of
6 the auction process and informal workshops to identify lessons learned, no formal
7 Commission review of the portfolio itself is contemplated. Given the magnitude
8 of the Company's service obligation, these matters I've referenced should be dealt
9 with in this proceeding. Although the Commission will always have the authority
10 to raise these matters, it is important to do so now because the options available,
11 after the fact, will inevitably be more constrained.

12
13 **IV. PROCUREMENT PROCESS ISSUES**

14 Q. WHAT DO YOU MEAN BY PROCUREMENT?

15 A. By procurement, I am referring to the process whereby the resources are actually
16 acquired. Obviously, an annual auction is one such procurement process. Other
17 procurement processes include negotiated bi-lateral agreements and Requests for
18 Proposals.

19 Q. WHAT ARE THE PROCUREMENT PROCESS ISSUES?

20 A. As noted earlier, the Company has proposed to acquire, in a single auction in
21 2006, full requirements contracts (of varying durations) to cover its up to 8000

1 MW obligation to its bundled service customers. Auctions held in subsequent
2 years would be of a smaller magnitude (33%), but the procurement would be
3 substantial and would occur in a single annual auction.

4 I agree with the Company that, because the full load will be served by
5 staggered contracts, in subsequent years customers may benefit if forward prices
6 decline; in addition, the impact of higher prices will be mitigated. The process
7 essentially results in a moving average of prices, which will always tend to mute
8 the impact of high or low increments.

9 With respect to the 2006 procurement, the risks associated with a single
10 auction purchase of this magnitude are not trivial, as will be discussed below. The
11 Company has not explained how it evaluated such risks and why, in light of them,
12 it has recommended the proposed approach.

13 Q. ARE THERE ALTERNATIVES TO AN ANNUAL AUCTION?

14 A. Yes there are. For example, accepting, for argument's sake, that the proposed
15 portfolio contains the best mix of products for bundled customers, the same
16 portfolio could be acquired by purchasing portions of required supply on a more
17 frequent or periodic basis. It is my view that more frequent procurements – even
18 if only to assemble the same portfolio -- would likely be less risky than the
19 Company's proposal. The administrative costs of acquiring the portfolio through
20 more than one process – whether more than one annual auction or otherwise --
21 may be greater, but these amounts will be very small in relation to both the overall
22 costs of the portfolio and to the risks that might be mitigated by doing so.

1 Q. WHAT ARE THE RISKS ASSOCIATED WITH THE COMPANY'S ANNUAL
2 AUCTION APPROACH?

3 A. There are risks and benefits associated with any procurement process and, indeed,
4 any portfolio. Hence, the important questions are always about relative risks and
5 benefits. The risks of the one-time auction are that: (a) the particular day of the
6 auction may be an inauspicious one from a market perspective; (b) if so, it would
7 exacerbate the problems of finding (in time for beginning 2007) reasonably priced
8 alternatives to spot products for bundled service customers; and (c) responsibility
9 for resolving major procurement decisions would be shifted to the Auction
10 Manager.

11 It is my understanding that the Company's proposal includes the
12 possibility of rescheduling the auction, should an "extraordinary event" take
13 place. These events appear to be *force majeure* types of events – such as the
14 "advent of war, disruption of a major supply source for potentially extended
15 periods, or other similar events that could significantly impact the cost of
16 supply..." (Ameren Ex. 6.9, p.17.)

17 It appears that "an extraordinary event must occur between the time at
18 which the maximum starting price and the minimum starting price are announced
19 (no later than 10 business days before the Part 1 Application is due) and the day
20 on which the auction starts." When an extraordinary event occurs, the Auction
21 Manager "will determine a revised maximum starting price and a revised
22 minimum starting price, and may also determine a revised schedule." Although
23 the Auction Manager makes these determinations in "consultation" with Ameren,

1 the Auction Advisor and the ICC Staff, the Auction Manager would ultimately be
2 responsible for potentially major procurement decisions that are typically
3 undertaken by planning and procurement teams at utilities that actively manage
4 power portfolios. (Ameren Exhibit 6.9, p.16-17)

5 Q. WHAT ABOUT EVENTS THAT ARE NOT EXTRAORDINARY?

6 A. From time to time, markets are affected by events that may not be considered
7 extraordinary, such as temporary run-ups in fuel prices; temporary forced outages
8 of major generating stations; and so on. Professional judgment is required to
9 assess what effect, if any, particular events should have on procurement practices.

10 In the absence of a professional portfolio/procurement team, the Company should
11 evaluate whether more frequent (several times per year) procurements, for
12 portions of 2007 and beyond, would result in less risk for its bundled service
13 customers.

14 More frequent procurements -- once per month, per quarter, or otherwise --
15 would provide more flexibility and would likely reduce the risks to the bundled
16 service customers that are inherent in a one-time procurement. As I've indicated
17 above, at the very least, alternative modes of acquiring the products the Company
18 has selected should be examined and compared with the one-time procurement.

19 Q. IS THERE ANY INDICATION THAT THE DATE OF THE AUCTION
20 WOULD BE MODIFIED UNDER THE CIRCUMSTANCES CITED IN YOUR
21 PREVIOUS ANSWER?

1 A. This is unclear. The Company states that it has not done any analysis of how the
2 timing of an auction can influence its results. (Ameren Response AG 2.20.)

3 When asked whether there were any circumstances that might make a
4 particular date inappropriate for the auction, Ameren points only to “extraordinary
5 events” as described earlier. (Ameren Response to AG 2.22.) It added that “it is
6 not the intention of the Ameren Companies to speculate or ‘out guess the market’
7 when deciding on when to hold the auction or the length of contract terms to be
8 procured.” (Ameren Response to AG 2.21.)

9 The risk of merely “speculating” in the market would be lessened if the
10 Company were to conduct more frequent and diverse procurements, whether by
11 auction or otherwise. The Company plans to hire an “agent” to run the auction
12 process. Alternatively, the company could hire an “agent” to engage in more
13 active management of the portfolio and procurements.

14 Q. WHAT IS THE ROLE OF THE COMMISSION IN THE AUCTION PROCESS?

15 A. The Commission will, with the assistance of its Auction Advisor, conduct a post-
16 auction review, within 3 business days following the auction, during which it will
17 take such information as may be required to either accept or reject the results of
18 the auction. As the Company indicates, if the reasons for the rejection are
19 essentially process-related and can be remedied, “then the appropriate corrections
20 would be made and it is expected the Auction Manager would re-run the auction.”
21 (Ameren Ex. 3.0 p. 21, line 481-482.)

22 Q. WHAT DOES THE COMPANY PROPOSE TO DO IF AN AUCTION IS
23

1 CANCELLED OR REJECTED AND CANNOT BE PROMPTLY RERUN?
2

3 The situation would be more complicated if the Commission's objection were
4 based upon reasons that could not easily be corrected. Presumably, this could
5 include concern about price levels or market conditions. If the Commission were
6 to reach such a conclusion, the Company proposes that it would "work with the
7 ICC Staff to develop an alternative procurement plan to be used to procure the
8 required BGS supply until the next scheduled CPA, after which the tranches of
9 BGS supply would be included in that next scheduled CPA." (Ameren Companies
10 Rider MVs.)

11 Of course, if a more flexible portfolio and procurement plan were
12 developed in the first instance, the risks and uncertainties associated with
13 extraordinary events or unacceptable auction outcomes could be more easily
14 absorbed -- and the Company would not be put in a position where it has to
15 scramble for alternatives and consumers would not be subjected to increased risks
16 and spot market prices. Consideration of various procurement options in this
17 docket can ensure that alternatives to the full requirements auction are explored
18 and evaluated now, before a crisis occurs.

19 Q. WILL THE COMMISSION BE ABLE TO ADEQUATELY REVIEW THE
20 AUCTION CLEARING PRICE DURING THE THREE DAY REVIEW?

21 A. There are essentially two elements to a review of auction clearing prices: (1) an
22 assessment of the risk premium associated with the fixed price, full requirements
23 contracts; and (2) an assessment of the underlying forward price structure.

1 Commission review of the first component, the risk premium, would
2 probably not present serious problems – provided the auction process is
3 adequately competitive and risk premiums are ‘squeezed’ as the competition
4 proceeds. On the other hand, one would expect the opposite result if there was
5 inadequate competition. If risk premiums are unreasonably high, this could
6 indicate inadequate wholesale competition or a problem with the auction itself,
7 requiring Commission intervention to protect consumers.

8 Commission review of underlying forward prices is another matter. The
9 concern here is how Commissioners and the Auction Advisor would determine
10 whether the forward prices – and, hence, the final clearing auction prices – were
11 somehow ‘too high’. At this point there does not appear to be any plan to present
12 relevant information to the Commission to make this determination.

13 Q. WHY ARE YOU CONCERNED ABOUT THIS ISSUE?

14 A. There are many types of market issues and problems that do not amount to major,
15 *force majeure* types of events. As I alluded to earlier, gas prices might run up; the
16 NRC might shut down some nuclear facilities; some major plants might
17 experience significant, and unexpected, forced outages. In some instances, it will
18 be clear to market participants that the events are likely to be transitory or portend
19 changes in fundamentals for some time (as in the recent increase in gas prices).
20 But in other circumstances, where this is not so, forward prices can be skewed. In
21 any event, as I understand it, the date of the auction will not be altered unless the
22 event(s) in question is (are) considered extraordinary. No alternatives to the
23 single annual auction were given any consideration or presented for comparison.

1 Q. DO YOU HAVE ANY OTHER CONCERNS ABOUT THE PROPOSED
2 AUCTION?

3 A. Yes. The proposed descending clock auction pays all successful bidders a
4 uniform market clearing price, regardless of their actual cost of supplying
5 electricity. As a result, inframarginal suppliers, whose costs are below the
6 clearing price will benefit financially, perhaps substantially. Ameren's proposal
7 calls for all energy and capacity to be obtained through this descending clock
8 auction. A descending clock auction is only one of many ways to obtain energy
9 and capacity and may not result in the lowest possible prices for electricity.
10 Ameren's failure to present other options – such as, for example, negotiated
11 bilateral contracts – means that opportunities for consumer savings may be lost.
12 Ameren should examine whether these other options could yield lower prices,
13 with risks that are reasonably acceptable to its customers.

14 Q. WHAT DO YOU RECOMMEND AT THIS JUNCTURE?

15
16 A. I recommend that the Commission require Ameren to present a complete analysis
17 of the rate impacts and risk levels for bundled customers associated with its
18 proposed portfolio design and procurement method, compared with a variety of
19 other portfolio design and procurement options.

20 Q. DOES THIS COMPLETE YOUR TESTIMONY?

21 A. Yes, it does.

22